Monday, August 31, 2020

On August 26, 2020, the U.S. Securities & Exchange Commission (SEC) adopted amendments to Rule 501, Rule 144A and other related rules (the Amendments) to expand the definition of “accredited investor” under the Securities Act of 1933 (the Securities Act). The amendments were adopted largely as proposed and broaden the scope of natural persons and entities that may qualify to participate in private offerings of securities that are exempt from registration under the Securities Act.

In particular, the “accredited investor” designation will now include the following:

- **Natural persons holding certain professional certification and designations.** The SEC will periodically issue orders designating those professional certificates, designations or credentials that, when held by a natural person, would qualify such person as an accredited investor. Contemporaneously with the Amendments, the SEC designated holders in good standing of the Series 7, Series 65 and Series 82 licenses as qualifying for accredited investor status. In evaluating additional professional designations for qualifying status, the SEC will consider a non-exhaustive list of attributes established by the Amendments.

- **“Knowledgeable Employees”** of private funds as defined under the
Investment Company Act, but only with respect to investment in such private fund. A Knowledgeable Employee’s spouse will also be considered an accredited investor with respect to joint investments in the private fund.

- **Certain enumerated entities**, including:
  - federal- or state-registered investment advisers and exempt reporting advisers, regardless of the level of assets under management;
  - rural business investment companies (RBICs), as defined in Section 384A of the Consolidated Farm and Rural Development Act;
  - limited liability companies that have total assets in excess of $5 million and were not formed for the purpose of acquiring the securities offered; and
  - any entity with at least $5 million in investments (as defined under the Investment Company Act of 1940) that has not been formed for the purpose of investing in the securities offered, in order to encompass entities such as Indian tribes, foreign entities and local government bodies that were not previously covered by Rule 501.

- **“Family offices” and their “family clients,”** each as defined under the Advisers Act, provided the family office has at least $5 million in assets under management, was not formed for the purpose of acquiring the securities offered and was directed to make the investment by a person who has such knowledge and experience in financial and business matters such that the family office is capable of evaluating the merits and risks of the investments.

The Amendments would also clarify that spousal equivalents can pool finances when determining qualification as an accredited investor and update the definition of “qualified institutional buyer” under the Securities Act to conform with the new accredited investor definition.

The expansion of the accredited investor definition has many implications for asset managers, including updates to offering and subscription documents and questionnaires, consideration of expanded options for funding GP commitments via the expanded pool of knowledgeable employees and affiliated professionals and evaluation of fund-raising opportunities. Commissioners adopted the amendments on a 3-2 vote, with commenters disagreeing with the SEC’s decision not to index the wealth thresholds, which were initially adopted in 1982, for inflation. The Amendments will go effective 60 days after publication in the Federal Register.

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1 While Rule 501 did not explicitly include LLCs meeting these requirements prior to the Amendments, the SEC historically has taken the position that such LLCs qualify as accredited investors.

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